

ST 96-27

Tax Type: SALES TAX

Issue: Rolling Stock (Purchase/Sale Claimed To Be Exempt)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	
)	
v.)	Docket #
)	
TAXPAYER)	IBT #
)	
)	
Taxpayer)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES

REPRESENTATIVE, for TAXPAYER

SYNOPSIS

This cause came on for hearing following a Retailers' Occupation and Use Tax audit performed upon TAXPAYER (hereinafter "taxpayer") by the Illinois Department of Revenue (hereinafter the "Department") for the period of July 1, 1981 through December 31, 1989. After completion of the audit work, the auditor reviewed the audit findings with the taxpayer who indicated his disagreement with them. The Department subsequently issued an assessment whose timely protest by taxpayer resulted in this contested case.

The primary issue is if certain buses purchased by taxpayer qualify for the rolling stock exemption. A related issue is if parts and accessories such as tires, anti-freeze, radios, fuel and miscellaneous other items also are entitled to the rolling stock exemption. Also at issue is the proper statute of limitations under which the Department can assess Use Tax for the various purchases in this matter.

After reviewing this matter, I recommend the issues be resolved partly in favor of the taxpayer and partly in favor of the Department.

FINDINGS OF FACT

1. Taxpayer conducted business operations in Illinois during the audit period by operating buses. (Tr. pp. 9-11; Dept. Ex. No. 2, pp. 13-14)

2. Taxpayer's main business activity was providing the school bus transportation for the County school district. Taxpayer also operated some coach buses used to charter groups to various destinations in the United States. (Dept. Ex. No. 2, p. 13)

3. For most transactions in which taxpayer purchased buses, parts and supplies during the audit period, taxpayer claimed the rolling stock exemption and paid no Retailers' Occupation or Use Tax. (Dept. Ex. No. 2 pp. 13-14, 31, 43-64)

4. The fuel used in his buses was purchased by taxpayer without paying Retailers' Occupation or Use Tax from July 1981 until mid-November, 1989. (Dept. Ex. No. 2, pp. 14 and 65-82)

5. Taxpayer did not provide any records in the form of purchase invoices for periods prior to 1987. (Dept. Ex. No. 2, p. 13)

6. Taxpayer introduced no documentary evidence to support its contention that various transactions on several submitted lists were non-taxable. (Tr. pp. 3-4)

7. Pursuant to statutory authority, the auditor did cause to be issued a Correction and/or Determination of Tax Due (SC-10) and this served as the basis for Notice of Tax Liability (NTL) No. F-902301 issued December 17, 1990 for \$86,139.59, inclusive of tax, penalty and interest. (Dept. Ex. Nos. 1 and 3)

8. The introduction of the Department's corrected return and NTL into evidence established its *prima facie* case. (Tr. p. 3; Dept. Ex. Nos. 1 and 3)

CONCLUSIONS OF LAW

Section 3 of the Use Tax Act (Ill. Rev. Stat. 1989, ch. 120, par. 439.3)¹ imposed Use Tax upon the privilege of using in this State tangible personal property, including buses, related parts and fuel acquired through purchase from a retailer. This same Section excluded from taxation:

"...the use, in this State, of tangible personal property by an interstate carrier for hire as rolling stock moving in interstate commerce or by lessors under a lease of one year or longer executed or in effect at the time of purchase of tangible personal property to interstate carriers for-hire for use as rolling stock moving in interstate commerce as long as so used by such interstate carriers for-hire;..."

The Department Regulation that defines "Rolling Stock" (86 *Illinois Administrative Code*, Chapter I, Section 130.340) states, in part:

"b) The term "Rolling Stock" includes the transportation vehicles of any kind of interstate transportation company for hire (railroad, bus line, air line, trucking company, etc.), but not vehicles which are being used by a person to transport its officers, employees, customers or others not for hire (even if they cross State lines) or to transport property which such person owns or is selling and delivering to customers (even if such transportation crosses State lines).

* * *

"d) The exemption applies to vehicles used by an interstate carrier for hire, even just between points in Illinois, in transporting, for hire, persons whose journeys or property whose shipments, originate or terminate outside Illinois on other carriers. The exemption cannot be claimed for an interstate carrier's use of vehicles solely between points in Illinois where the journeys of the passengers or the shipments of property neither originate nor terminate outside Illinois."

While Section 130.340 was promulgated by the Department as a Retailers' Occupation Tax Regulation, it has been incorporated by reference into the rules employed by the Department in its administration of the Use Tax Act. See 86 *Ill. Adm. Code*, Ch. I, Section 150.1201.

In order for the use of tangible personal property to be exempt from Illinois Use Tax pursuant to the "Rolling Stock" exemption, the foregoing statutory and regulatory language requires that certain conditions be met. One

¹. This and subsequent statutory citations are those that were in effect during the audit period.

is that the tangible personal property must be a transportation vehicle (or an integrated or attached part of a system thereof) purchased by an interstate transportation company for hire. Another is that the item be used by an interstate carrier for hire as rolling stock, moving in interstate commerce, or moving in intrastate commerce if the person/cargo's transportation journey begins or ends outside of Illinois. Another condition is that the purchaser of the item must be the interstate carrier for hire, or a lessor under lease of one year or longer executed or in effect at time of purchase to an interstate carrier for hire. Also, Subsection (e) of Regulation 130.340 requires that for a purchaser to claim the exemption, it should give the seller a certification that the purchaser is an interstate carrier for hire, and the purchaser is purchasing the property for use as rolling stock moving in interstate commerce. The Department is authorized to go behind such a certification and disregard it if the Department determines that the purchase was taxable based upon its examination of the purchaser's records or activities.

That is the situation in the instant case as the taxpayer purchased buses, parts and other items tax-free by claiming the rolling stock exemption, and then the auditors' examination of taxpayer's records and activities led the auditors to conclude only a portion of taxpayer's business activities involved transporting passengers for hire across state lines in interstate commerce, and this was the charter trips on its coach buses.

Because this is a question of tax exemption, the fundamental rule of construction is that the exemption provision is to be strictly construed against the one who asserts the claim of exemption. International College of Surgeons v. Brenza, 8 Ill.2d 141 (1956) In this case, as in all tax exemption cases, a taxpayer's claim that a certain purchased item is tax exempt must be analyzed in the context that entitlement to exemption must be proven by the taxpayer, and doubts regarding the applicability of the exemption will be resolved in favor of taxation. A party claiming an exemption has the burden to prove clearly and conclusively that he is entitled to the exemption. (Christian Action Ministry

v. Department of Local Government Affairs, 74 Ill.2d 51, 62 (1978); Telco Leasing, Inc. v. Allphin, 63 Ill.2d 305, 310 (1976); LeTourneau Railroad Services, Inc. v. Department of Revenue (1985), 134 Ill.App. 3d 638, 642)

While taxpayer contends it is entitled to exemption for the school buses it purchased, as well as related parts, there is insufficient verifiable documentary evidence in this record for me to agree. I cannot conclude these buses were used by taxpayer as rolling stock based upon Taxpayer Ex. No. 2, which is a list of alleged trips made in interstate commerce by the school buses. Just listing a group of trips is not sufficient to satisfy the documentation standards. Other than the Illinois embarkation point and the out-of state destination there is no other information submitted regarding the alleged interstate commerce trips. While taxpayer testified the trips came from a book he kept, no such book, or sample thereof, was offered into evidence and there were no vehicle trip sheets, logs, mileage amounts, or other records submitted. Further, the list does not identify any of the buses by number, does not state the reason or purpose for the trip, and does not state the identity of any passengers, other than the list's very broad title "School Work." While taxpayer argues he was contractually required to make interstate trips with the school buses pursuant to his contract with the school district, no such contract was offered into evidence.

Although taxpayer did submit some documents (Taxpayer Ex. No. 3) showing he used school type buses in transporting job corps students, all of these have dates showing they occurred in 1991 or 1992, well after the audit period that ended in December 1989. I do not have to decide if such usage would constitute rolling stock moving in interstate commerce because the assessment at issue herein is limited to the time period reviewed by the auditors, and anything that happened afterwards in the taxpayer's business activities is immaterial and irrelevant to the issues herein. The Department's examination to determine if usage occurred as rolling stock could only be made for the time period from time of purchase up to the conclusion of the audit work using documents that had been

obtained for that period. The Illinois Appellate Court has determined that in a situation like this it is reasonable for the Department to limit its review of the usage of the transportation vehicle to the time period encompassed by the audit. Accordingly, I will not consider documents Taxpayer submitted at the hearing that cover time periods in 1991 and 1992. See Chicago & Illinois Midland Railway Company v. Department of Revenue, 66 Ill.App. 3d 397, 399-400, (First Dist. 1978).

Another issue is the proper statute of limitations. For the audit time frame Section 5 of the Retailers' Occupation Tax Act, as incorporated by reference into the Use Tax Act (Ill. Rev. Stat. ch. 120, pars. 439.12 and 444), authorized the Department to assess transactions back to July 1, 1981 when a business entity had not filed returns. Gallagher Drilling v. Department of Revenue, 228 Ill.App. 3d 490 (Fourth Dist. 1992); Sargent & Lundy v. Sweet, 207 Ill.App. 3d 888 (First Dist. 1990), app. denied 137 Ill.2d 672.

Counsel argues that because the retailers who sold taxpayer its parts and fuel filed sales/use tax returns, the Department is precluded from assessing transactions occurring prior to 1987 (Taxpayer 9/6/95 Brief, pp. 11-13). I cannot agree. I first point out that no copies of taxpayer's vendor's returns or other documentary evidence was submitted to support this contention. A review of the auditor's interest computation schedules (Dept. Ex. No. 2, pp. 32-38) shows that the taxpayer's average monthly use tax liability was in excess of \$160.00 for the first 30 months of the audit period and over \$350.00 for the remaining months. I therefore find taxpayer was a non-filer who the Department properly assessed because taxpayer was obligated to be registered and filing returns under the provision in Section 10 of the Use Tax Act that imposed this requirement upon a user who had a frequently recurring direct use tax liability to pay to the Department. (Ill. Rev. Stat. ch. 120, par. 439.10)

Taxpayer did submit as part of its Exhibit No. 1 some RR-556 transaction reporting returns filed by vehicle retailers with the Illinois Secretary of State for bus purchases taxpayer made in 1981 and 1982. Because these documents

show the retailers had filed the transaction reporting returns at the time of the sale, with executed RUT-7 rolling stock exemption certificates attached, I find the statute of limitations for these bus purchases to be July 1, 1987. These 556's are evidence the returns on the particular transactions were filed with the State, and they also show that the exemption certificate as part of the filing was available for the Department to examine and audit. I therefore recommend the tax attributable to these buses be deleted from calculation of the final assessment. These transaction reporting returns in Taxpayer Ex. No. 1 show purchases from Bus Sales of \$19,900 (10/28/81), \$3,500 (1/29/82), \$1,500 (11/16/81), \$9,000, (11/30/81) and \$2,500 (2/23/82).

Taxpayer submitted its Exhibit No. 13 to show that one transaction was taxed twice by the Department. (Tr. p. 36) I agree with taxpayer as audit schedule 7-2(B), already in the record (Dept. Ex. No. 2, pp. 53-54), shows that this transaction with Upholstery Co., Inv. # 10454 (5/14/87) is included on two separate sheets. I therefore recommend the tax on this transaction be deleted from the final assessment.

Taxpayer testified the items on its Exhibit No. 14 should be exempt because they are air conditioning parts and freon used only on the exempt coaches. I note that the auditors, after initially scheduling certain transactions taxpayer had with Products, Inc. as taxable (Dept. Ex. No. 2, p. 49), subsequently eliminated them from the taxable exceptions on the basis they were all purchased for exempt charter coaches. Similarly, because the air conditioning parts and freon could only be used on the exempt charter coach buses, I recommend the tax attributable to the invoices listed on Taxpayer Ex. No. 14 be deleted from the final assessment.

Taxpayer also submitted as exhibits several other lists of transactions that it contends are exempt for various reasons. Unfortunately for the taxpayer, most of these exhibit lists are either not justified by a valid reason for tax-free status or lack supporting documentation from taxpayer's records

required to be submitted in conjunction therewith to corroborate a valid deduction or exemption.

Taxpayer Exhibit Nos. 5, 6, 7, 9, 12, and 17 were offered for the purpose of showing that certain transactions were exempt because of being for farm use, labor, returned cores, unlocatable or not taxpayer's invoices, and returned parts or discounts. (Tr. pp. 20, 22-24, 27 34-35 and 44) I cannot concur with taxpayer that these purchases are non-taxable. Just submitting lists of transactions and saying they are not subject to tax does not satisfy the documentation standards established and required by statute and case law. These standards require competent documentary evidence in the form of taxpayer's books and records and such documentation must normally be offered in conjunction with testimony to show why assessed transactions are not subject to tax.

Taxpayer submitted both its Exhibit Nos. 8 and 19 on the basis the listed assessed amounts are non-taxable due to the charges being for freight or delivery. I cannot agree or accept them for this purpose as no evidence, documentary or otherwise, was submitted by taxpayer to establish the existence of a separate contract for the freight or delivery charges. (Tr. pp. 25, 46-47) The existence of a separate contract is necessary to show that the freight/delivery charges are not part of the selling price of the goods being purchased. See 86 *Ill. Adm. Code* Ch. I, Sec. 130.440.

Taxpayer contends the items on its Exhibit No. 10 are not taxable because the purchases/repair work occurred outside of Illinois. This mere assertion by itself does not establish non-taxable status because taxpayer would still be liable for Illinois Use Tax or Service Use Tax, unless it could show through documentary evidence that it properly paid a sales/use tax to another state.

Taxpayer testified that 40% of the amounts on its Ex. No. 15, a list of purchased shop supplies, should be exempt because they were used on items for its charter coaches. This is not a valid reason for exemption because while parts used on or physically incorporated into an exempt vehicle can qualify, these items on Taxpayer Ex. No. 15 are consumable supplies used in taxpayer's

shop. Examples are grinding wheels, (Invoice # 12810, 6/5/87) and service lamps (Inv. #s 12465-2/16/87 and 13704-3/7/88, see Dept. Ex. No. 2, pp. 44-46).

Taxpayer testified that when he purchased the items on its Ex. No. 16, he paid the tax even though the ticket didn't separate the tax, with examples being Invoice # 3751 from Lumber and #1369 from a pawn shop. (Tr. p. 41) I cannot conclude taxpayer paid the tax on these transactions as I cannot tell from examining the items listed on Ex. No. 16 that tax was paid. Further, an Illinois retailer is required to collect and state the tax as a separate and distinct item apart from the selling price of the tangible personal property that is being sold. (Ill. Rev. Stat, ch. 120, par. 439.3a) If the tax is not stated separately, it is assumed that it was not collected. Central Furniture Mart v. Johnson, 157 Ill. App.3d 907, 910 (1st Dist. 1987)

Taxpayer testified it was submitting its Exhibit Nos. 4, 11, 18, 20, and 21 to show that various parts and other items it purchased such as paint, anti-freeze, and radios are exempt because they were used on the charter coach buses and were not used on the assessed school buses. (Tr. pp. 17-19, 33, 45, 48-49 and 51-52) However, the Department auditor had already allowed a portion of parts purchases as exempt by virtue of being used on the charter coaches. (Dept. Ex. No. 2, pp. 47, 63) To approve these exhibit items for exemption would mean a double credit situation. The auditor determined the percentage of exempt charter bus usage by comparing taxpayer's revenues from the exempt charter coach buses to its revenues from the non-exempt school bus operations and I find this audit procedure meets a minimum standard of reasonableness. Most of these part items appear on audit schedule 7-2(B), and it is on this schedule of parts, tires, etc. where the auditor reduced the taxable amount by his charter bus percentage. A couple of transactions that are on Taxpayer Ex. No. 21 are not on schedule 7-2(B), but instead are on schedule 7-1(B), where no exempt charter usage adjustment was made. I find this was proper because these radio items went onto the non-exempt school buses. Similarly, it was proper for the Department to make no adjustment for the few items on Taxpayer Ex. No. 20

that were taxed on audit schedule 7-2(A) because these items are consumable supplies such as oil cans and small tools not capable of being incorporated into an exempt vehicle.

Taxpayer testified the auditor was not consistent in his treatment of taxpayer's purchases of fuel because he assessed tax upon the federal excise tax portion of some purchases but not on others. (Tr. p. 52; Taxpayer Ex. No. 22) My examination of Taxpayer Ex. No. 22, which is an annotated copy of audit schedule 7-2(C) (Dept. Ex. No. 2, pp. 65-82), shows the auditor's taxation of the federal excise tax was proper. According to federal statute the legal incidence of the federal excise tax on sales of diesel fuel was on the consumer and thus not part of the sales/use tax base prior to April 1, 1988. It became part of the tax base thereafter because the federal government changed the legal incidence of this excise tax from the consumer to the importer/producer on and after April 1, 1988. 86 *Ill. Adm. Code*, ch. I, Sec. 445; 26 U.S.C. 4091.

In summary, I find that with the exception of the tax on the buses covered by the 556's in Taxpayer Ex. No. 1 and the transactions in Taxpayer Exhibits 13 and 14, the liability as shown in the Notice of Tax Liability should stand as issued.

RECOMMENDATION

Based upon my findings and conclusions as stated above, I recommend the Department reduce NTL XXXXX and issue a final assessment.

Karl W. Betz, Administrative Law Judge